

IN THE
UNITED STATES CIRCUIT COURT OF APPEALS
FOR THE NINTH CIRCUIT.

COMMISSIONER OF INTERNAL REVENUE, *Petitioner,*

v.

NATIONAL RESERVE INSURANCE COMPANY, *Respondent.*

On Petition for Review of the Decision of the Tax Court
of the United States.

AMICUS CURIAE BRIEF OF THE TEXAS ASSOCIA-
TION OF MUTUAL LIFE INSURANCE OFFICIALS.

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INTEREST OF AMICUS CURIAE.

The Texas Association of Mutual Life Insurance Officials is an association of officials of assessment life insurance companies operating in Texas. Such companies have approximately two million policyholders. In many instances the insurance carried by the members of the Texas assessment life insurance companies is the only life insurance carried by the members. If the assessment life insurance com-

panies are not taxed as "life insurance companies" under the Internal Revenue Code they cannot hope to survive in competition with companies taxed as "life insurance companies". In that event the probabilities are that a great many of the persons insured in assessment life insurance companies will not be able, because of age or health, to secure insurance from other companies. It is obvious, therefore, that the importance of the case at bar extends far beyond the interest of the particular company involved in this litigation. Consequently, the Texas Association of Mutual Life Insurance Officials desires to present its views.

In Texas, assessment life insurance companies are required to pay at least sixty percent of their assessment income, exclusive of membership fees, into a mortuary fund held for the payment of policy claims. The Board of Insurance Commissioners permits payments out of the mortuary fund "of all attorneys' fees and necessary expenses arising out of the defense, settlement, or payment of contested claims".

Our concern is occasioned by the dissenting opinion in the case at bar because if its reasoning is adopted by this Court, it may throw a cloud over the tax status of Texas assessment life insurance companies which pay incidental contested claim expenses out of mortuary funds.

ARGUMENT.

The Government argues that this company should be denied the status of a "life insurance" company because its reserve funds are not held exclusively for the fulfillment of life insurance and annuity contracts. The Government admits that the statute does not specifically state that the reserve must be held "exclusively" for the fulfillment of such contracts, but that "this is its only reasonable interpretation". (Br. 12)

Even if the statute provided, as it does not, that the reserve funds must be held exclusively for the fulfillment of policy contracts, the Tax Court decision would be correct.

The record in the case clearly shows that the reserve or mortuary fund was used for the following purposes:

1. Payment of policy claims.
2. Payment of refunds to policyholders of amounts collected in excess of amounts required to protect policyholders.
3. Payment of attorney's fees and other expenses incidental to the settlement of policy claims. Such expenses "were not excessive". (R. 28)
4. Minor items totalling \$34.99 in 1939 and \$47.03 in 1940 were erroneously charged to the mortality fund. (R. 28)
5. In addition, the by-laws of the taxpayer provide that a portion of the *savings* in the reserve fund may be set aside by the Board of Directors for the purpose of organizing a legal reserve life insurance company for the benefit of the taxpayer's members. (R. 102)

After the payments enumerated above the mortality reserve exceeded the reserve required by the Corporation Commission to protect policyholders. (R. 28)

The word "exclusively" has been the basis of tax litigation and its meaning in taxation is thoroughly established. Thus, in *Trinidad v. Sagrada Orden etc.*¹ a religious order claimed exemption from taxation as a corporation "organized and operated exclusively for religious, charitable * * * or educational purposes * * *". The Order had large properties consisting of real estate, stocks in private corporations, and money loaned at interest. Income from such properties, plus income from the sale of wine, chocolate and other articles, and income from other sources, amounted to 254,702.69 pesos in the year involved. The Government contended the religious order was not operated "exclusively" for religious purposes, but it operated also for busi-

¹ 263 U. S. 578, 4 A. F. T. R. 3802.

ness and commercial purposes in that it used its properties to produce income and traded in wine, chocolate and other articles. The Supreme Court held (p. 582):

“In using the properties to produce the income, it therefore is adhering to and advancing those purposes.”

Later, the Supreme Court states:

“Our conclusion is that the plaintiff is organized and operated exclusively for religious, charitable and educational purposes within the meaning of the excepting clause.”

The Board of Tax Appeals has stated the rule as follows:²

“In determining whether property is exempt as ‘used exclusively’ for certain purposes, the decisions have uniformly held that such language means the primary and inherent use and does not preclude such incidental uses as are directly connected with, essential to, and in furtherance of, the primary use.”

See also: *Edward T. Bedford*³; *Koon Kreek Klub v. Thomas*,⁴ and *Commissioner v. Chicago Graphic Arts Federation Inc.*⁵

The reasoning of the dissenting opinion in the case at bar may be erroneous for another reason.

In the case at bar, the following factual situation exists:

1. The state statute requires that a mortuary or reserve fund be created out of which may be paid all benefit claims arising under the certificate of membership plus the expenses incident to contested claims. (R. 24)

² Y. M. C. A. Retirement Fund, Inc., 18 B. T. A. 139, 145.

³ 39 B. T. A. 1039.

⁴ (C. C. A. 5) 108 F. (2d) 616, 24 A. F. T. R. 58.

⁵ (C. C. A. 7) 128 F. (2d) 424, 29 A. F. T. R. 524.

2. Except for the first year the Corporation Commission required that not less than 50 percent of the premiums be placed in the mortality reserve fund. That amount was deemed sufficient to enable the reserve fund to meet all the requirements of the American Standard Mortality Table on the basis of $3\frac{1}{2}\%$ interest accretions. (R. 26)

3. The taxpayer was required by the Corporation Commission to make refunds to policyholders of savings in the Death Benefit or Mortality Funds. (R. 27)

4. The taxpayer's reserve or mortality fund after refunding the savings to policyholders was in excess of the reserve required by the Commission to protect policyholders. (R. 28)

In *New York Life Insurance Company v. Bowers*,⁶ the Supreme Court was squarely confronted with the question of whether "dividends" or insurance savings were properly part of the life insurance reserves or merely surplus or contingent reserves maintained for the general use of the business. The Supreme Court states (p. 245):

"The sums to be paid as dividends are not a part of the insurance specified in the policies. They are derived from amounts which, from abundant caution, are included in the advance premiums over and above what is found by actual experience to be necessary to pay the cost of the insurance and the expenses of carrying on the business. They indicate a 'surplus' i.e., assets in excess of what is deemed necessary to provide for the payment when due of the amounts specifically covered by the policies."

In *Helvering v. Inter-Mountain Life Insurance Company*⁷ the Supreme Court reiterated its understanding of the term "reserve" as follows (p. 690):

⁶ 283 U. S. 242, 9 A. F. T. R. 1425.

⁷ 294 U. S. 686, 15 A. F. T. R. 280.

“In life insurance the reserve means the amount accumulated by the company out of premium payments, which is attributable to and represents the value of the life insurance elements of the policy contracts. * * * Life insurance matures only upon the death of the insured and the life reserve is based upon that contingency * * *.”

Treasury Regulations recognize the rule as expressed above, as follows:⁸

“* * * Life insurance reserves do not include reserves required to be maintained to provide for the ordinary running expenses of a business definite in amount, and which must be currently paid by every company from its income if its business is to continue * * * nor do they include * * * liability for annual and deferred dividends declared or apportioned * * *.”

In the case at bar, it is obvious that neither the company nor the Corporation Commission expected the excess premiums or assessments to remain in the mortality fund. It was anticipated that the excess would be refunded or used for the benefit of policyholders. Consequently, such excess was never legally a part of the mortality fund from a Federal tax viewpoint. That being true, the premium refunds and other disbursements have no effect on the “exclusive” use of the fund to pay mortality claims.

CONCLUSION.

The decision of the Tax Court is correct. It should be affirmed.

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⁸ Reg. III, Sec. 29.201-4.